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C O N F I D E N T I A L SECTION 01 OF 03 LAGOS 001369

SIPDIS

DOE FOR DAS JBRODMAN AND CGAY
TREASURY FOR ASEVERENS AND SRENENDER
DOC FOR KBURRESS
USAID FOR GWEYNAND AND SLAWAETZ
STATE PASS TRANSPORTATION FOR MARAD
STATE PASS OPIC FOR ZHAN AND MSTUCKART
STATE PASS TDA FOR NCABOT
STATE PASS EXIM FOR JRICHTER
STATE PASS USTR FOR ASST USTR SLISER

E.O. 12958: DECL: 08/31/2015

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SUBJECT: NNPC HEAD TELLS OIL MAJORS - CONSTRUCT REFINERIES,
OR FACE MILLIONS IN FINANCIAL PENALTIES

REF: LAGOS 1341

Classified By: Consul General Brian L. Browne for Reasons 1.4 (D & E)

Summary

1. (C) ConocoPhillips Managing Director (MD) Todd Creeger briefed us on an August 25 meeting between the Nigerian National Petroleum Corporation Group Managing Director (GMD) Kupolokun and the MDs of Nigeria's major energy companies. Kupolokun told the MDs he was under intense pressure, apparently from President Obasanjo, to conclude an agreement on domestic refining by the majors. In an initial move that seemed to hold some promise, Kupolokun signaled willingness to pay the going international rate if the majors agreed to domestic refining. However, the prospect of compromise quickly faded when he revealed the GON's real objective - in the name of corporate social responsibility, the majors should construct new refineries, or face multi-million dollar penalties.

Kupolokun Outlines Demand for Domestic
Refining Agreement within 30 Days

2. (C) During an August meeting with the Energy Officer, ConocoPhillips Managing Director (MD) Creeger summarized an August 25 meeting between the NNPC GMD Kupolokun and Nigeria's major energy companies. Kupolokun told the oil MDs, "I'm under pressure; I've been given a month to conclude an agreement," to ensure the majors refine some of their crude domestically. He explained the GON was looking to link the oil industry with the rest of the economy through additional local content. Apparently under marching orders from President Obasanjo, who has made a political decision on this issue, he warned, "there is no legal argument that can wish this away."

Kupolokun Fills in Technical Details on NNPC Proposal

3. (C) During the meeting, Kupolokun explained new technical details concerning NNPC's proposed regulations circulated in early August (reftel). NNPC wants the majors to deliver 380,000 barrels/day to the national refineries, a little over half of Nigeria's estimated 700,000 barrel/day demand. While the nameplate (maximum) capacity of Nigeria's four refineries (Port Harcourt I and II, Warri, and Kaduna) is actually 445,000 barrels/day, Kupolokun acknowledged the refineries were not working at capacity. (Note: In reality, the refineries are working at about 50 percent capacity, and would have to sweat and strain to reach production of even 380,000 barrels/day. Refinery capacity careens wildly from month to month, depending on whether NNPC has provided funds for maintenance. During the last year, reports indicate the refineries have fluctuated between twenty to eighty percent capacity. The refineries are unable to retain revenues they generate to cover operational and routine maintenance expenses. Instead, they depend on infrequent transfers from NNPC headquarters. For example, the Managing Director of the Port Harcourt refineries told us he waited 14 months for funds to repair the Port Harcourt II refinery. End note.)

Kupolokun Offers Olive Branch -
Payment in Line with International Prices

4. (C) MD Creeger indicated during the first phase of Kupolokun's meeting, there was significant positive movement. Kupolokun for the first time agreed NNPC would pay the going rate for the majors' crude. (Note: The majors' singular objection to selling their crude to Nigerian refineries, or

to building greenfield refineries, has consistently centered on their refusal to sell into a price-regulated market. End note.) Kupolokun assured the MDs he "would make them whole," i.e., he would commit NNPC to paying the majors the going international rate for their crude, minus relevant transport costs. With this assurance, Creeger indicated most of MDs (excepting AGIP's) began to warm to Kupolokun's proposal.

The Other Shoe Drops: Build Refineries,
Take over Downstream, or Face Millions in Penalties

15. (C) Just as the interlocutors seemed on the verge of making progress, Kupolokun dropped a bomb, revealing the GON's true demand. Within the next month, the GON wants the majors to commit to construct refineries, as well as assume responsibility for distribution and sales of petroleum products. If they did not play ball, the majors would face severe financial penalties in the tens of millions of dollars. Kupolokun told the MD's Nigeria needed to balance its domestic consumption and domestic refining capability, and that all problems in the downstream sector needed to be fixed, not just access to sufficient crude. He chastised the MDs for thinking that access to upstream crude was the real issue, pointing out, "I could divert my own (i.e., NNPC's) production to fill the refineries." Instead, Kupolokun explained refinery maintenance and downstream distribution were also serious concerns the majors needed to help the GON tackle.

"Corporate Social Responsibility doesn't Equal
Refineries"; Kupolokun Dismisses Protests with a Threat

16. (C) MD Creeger reported the Total MD then protested corporate social responsibility did not require building multi-billion refineries (with no hope of a profitable return). Kupolokun replied, "I strongly encourage you to take part in the privatization of the parastatal refineries and to conclude agreements to build refineries - or you'll be left exposed." The Total MD then argued the proposed penalties would cost his firm a post-tax \$50 million loss per year. (Note: As Total is a relatively small operator, potential losses to ExxonMobil and Chevron would be much higher. End note.)

Kupolokun Threatens Harsher Action by the National Assembly

17. (C) Kupolokun also threatened action by the National Assembly if the majors comply. He asserted the National Assembly was prepared to pass a bill "within a week" to mandate domestic refining. Kupolokun cautioned any bill passed by the National Assembly would be harsher than the proposed regulations from NNPC. (Note: Kupolokun could be right. While the NNPC proposal is very bad, some of the proposed legislation making the rounds in the Assembly is worse. A current National Assembly proposed Petroleum Act amendment would mandate the majors to refine half of Nigeria's crude in country - more than a million barrels a day, far in excess of the country's installed refining capacity. Even Kupolokun considers this bill ill-advised, and has helped in holding this bill in stasis for several months. However, should Kupolokun and Petroleum Minister of State Daukoru release the executive branch throttle, the legislature may likely rush the measure towards passage. End note.)

Moving Forward - Meeting to Re-Convene Soon

18. (C) Kupolokun indicated this week he would send out a revised proposed regulations, reflecting the majors' feedback. He told the MDs they would re-convene within two weeks to reconsider the amended document.

Comment

19. (C) Call it what you will, Kupolokun is putting a tight squeeze on the oil companies. This portends to be a high stakes game of which side will back down first. The majors were deeply concerned with NNPC's push for them to refine some product domestically. This new demand for multi-billion outlays for at best, marginal refineries, is even more alarming. The proposal threatens investor rights, including contract sanctity and effective ownership and control of private property. The proposed regulations would further damage Nigeria's investment climate in general, and the investment climate in the petroleum sector more specifically. There are indications the oil majors' patience with the GON may be thinning. For now, an encounter between the unstable forces of Nigerian domestic politics, and the immovable object of the majors' financial logic, seems to be in the offing. The sides will have to find a meaningful and significant course adjustment to avoid a showdown over this

issue of the refineries.

110. (U) This cable was cleared by Embassy Abuja.
BROWNE